

Assembly California Legislature

"Keeping Up with PACE: A Joint Oversight Hearing on Residential Property Assessed Clean Energy Programs"

Assembly Committees on Local Government and Banking and Finance

**Thursday, June 9, 2016
10:00 a.m. – 1:00 p.m., State Capitol, Room 437**

Agenda

1) Welcome and Opening Remarks

--**Susan Talamantes Eggman**, Chair, Assembly Local Government Committee

--**Matt Dababneh**, Chair, Assembly Banking and Finance Committee

2) Overview of PACE Programs in California

--**Carolyn Chu**, Senior Fiscal & Policy Analyst, Legislative Analyst's Office

--**Deana J. Carrillo**, Executive Director, California Alternative Energy and Advanced Transportation
Financing Authority (CAEATFA)

3) Federal Housing Finance Agency's Perspective of California's PACE Program

--**Alfred Pollard**, General Counsel, Federal Housing Finance Agency (FHFA)

4) Implementation at the Local Government Level

--**Jane Elias**, Program Manager, Sonoma County Energy Independence Program (EIP)

--**Jenine Windeshausen**, Placer County Treasurer-Tax Collector, -mPOWER Placer

--**Barbara Spoonhour**, Director of Energy and Environmental Programs, Western Riverside Council
of Governments

--**James Hamill**, Managing Director, California Statewide Communities Development Authority

--**Dan Mierzwa**, Treasurer & Tax Collector, Yuba County

5) Third Party PACE Administrators

--**Ari Matusiak**, Executive Vice President of Market Development & External Affairs, Renovate America

--**Cliff Stanton**, Executive Vice President, Renew Financial

--**Mike Lemyre**, Senior Vice President, Ygrene Energy Fund

6) Impacts of Residential PACE on California's Housing Market

--**George Cook, Jr.**, Chief Executive Officer, El Dorado Savings Bank

--**Tony Diaz**, Vice President of Compliance at Schools, First Federal Credit Union

--**Craig Page**, Executive Vice President & General Counsel, California Land Title Association

--**Stan Wieg**, Staff Vice President, California Association of Realtors

--**Elizabeth M. Knight**, President, PLM Lender Services, Inc.

7) Public Testimony

8) Closing Remarks and Adjournment

Assembly
California Legislature
Committee on Local Government

SUSAN TALAMANTES EGGMAN, Ph.D.
CHAIR

CONSULTANTS
DEBBIE MICHEL
ANGELA MAPP
MISA LENNOX
COMMITTEE SECRETARY
DIXIE PETTY

**"Keeping Up with PACE: A Joint Oversight Hearing on
Residential Property Assessed Clean Energy (PACE) Programs"**

Assembly Committees on Local Government and Banking and Finance
Thursday, June 9, 2016
10:00 a.m. – 1:00 p.m., State Capitol, Room 437

Background for Assembly Local Government Committee Members

Hearing Goal

In 2014, the Assembly Local Government Committee held an informational hearing on Property Assessed Clean Energy (PACE) programs in California in order to provide members with more information about PACE, the role of the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA), and the experience of local agencies that implemented PACE programs in their jurisdictions. At the inception of the PACE program, the presence of third party administrators and the accompanying complex financing structures were not contemplated by the Legislature. Currently, very few local governments administer their own PACE programs, and instead, contract out to third party administrators.

The purpose of this hearing is to provide oversight on the current administration of PACE programs, examine the several models local governments use to offer PACE financing, and gain a better understanding of concerns expressed over residential PACE and the impacts on the financial market.

Background on PACE

Utilizing the authority to create a financing district as a charter city, the City of Berkeley, in 2007, established a citywide voluntary program to allow residential and commercial property owners to install solar systems and make energy efficiency improvements to their buildings and to repay the cost over 20 years via an assessment on the property tax bill. In 2008, the Legislature granted the statutory authority to cities and counties to provide up-front financing to property owners to install renewable energy sources or energy efficiency improvements that are permanently fixed to their properties, which is repaid through the property tax bill.

Most PACE programs are implemented and administered under two statutory frameworks: AB 811 (Levine), Chapter 159, Statutes of 2008, amended the Improvement Act of 1911, to allow for voluntary contractual assessments to finance PACE projects, and SB 555 (Hancock),

Chapter 493, Statutes of 2011, amended the Mello-Roos Community Facilities District Act to allow for Mello-Roos special taxes (parcel taxes) to finance PACE projects.

The Legislature has expanded PACE for residential and commercial property owners as an option to pay for renewable energy upgrades, energy and water efficiency retrofits, seismic improvements, and other specified improvements for their homes or buildings. Local agencies create PACE assessment districts under AB 811 or establish a Community Facilities District (CFD) under SB 555, allowing the local agency to issue bonds to finance the up-front costs of improvements. In turn, property owners enter into a voluntary contractual assessment agreement with the local agency or agree to annex their property into a CFD to re-pay the bonds via an assessment or special tax, secured by a priority lien, on their property tax bill. The intent of the program is that the assessment or parcel tax remains with the property even if it is sold or transferred, and the improvements must be permanently fixed to the property.

In California, there are several models available to local governments in administering a PACE program. Only the counties of Sonoma and Placer administer their own PACE programs. The majority of local governments contract with a private third-party or join a Joint Powers Authority (JPA), which contracts with a private third-party to carry out their PACE programs. The cost of third-party administration is not borne by the local agency, but is built into PACE loan financing. Some of these programs focus on residential projects, others target commercial projects, and some handle both residential and commercial portfolios.

In 2010, the Federal Housing Finance Agency (FHFA), which oversees the nation's largest mortgage finance companies, Fannie Mae and Freddie Mac, raised concerns that residential PACE financing could pose a risk for federal mortgage enterprises (Fannie Mae and Freddie Mac), because PACE loans are a first-priority lien in the case of foreclosure and outstanding PACE assessments would be paid before mortgage costs. FHFA specifically pointed to the underwriting for PACE programs, which result in collateral-based lending, rather than lending based upon ability to pay. FHFA statements also reference the absence of Truth in Lending Act and other consumer protections. In August of 2010, Fannie Mae and Freddie Mac announced they would not purchase mortgages for homes with first lien priority PACE obligations. The FHFA's action triggered many local governments to suspend their residential PACE programs.

The State of California and several other parties sued FHFA for not conducting a formal rulemaking before its decision; however, the 9th Circuit Court of Appeals ruled in FHFA's favor in March of 2013. (*County of Sonoma, et al. v. Federal Housing Finance Agency*, 710 F.3d 987 (2013)).

SB 96 (Committee on Budget and Fiscal Review), Chapter 356, Statutes of 2013, sought to address FHFA's decision, and tasked CAEATFA with administering a PACE loss reserve program of \$10 million to keep mortgage interests whole during a foreclosure or a forced sale. CAEATFA established regulations, and the majority of PACE administrators participate in the program. The PACE Loss Reserve Program is designed to compensate first mortgage lenders for losses resulting from the existence of a PACE lien in a foreclosure or forced sale. The program covers PACE payments made during foreclosure, if a mortgage lender forecloses on a home that has a PACE lien, and any losses to a first mortgage lender up to the amount of outstanding

PACE payment, if a county conducts a forced sale on a home for unpaid taxes. The intent of the Program is to put the first mortgage lender in the same position it would be in without a PACE lien.

The FHFA issued clarity to their position following the creation of the PACE Loss Reserve Program, in a letter to Governor Brown dated May 1, 2014, which reads, "I am writing to inform you that FHFA is not prepared to change its position on California's first-lien PACE program and will continue to prohibit the Enterprises from purchasing or refinancing mortgages that are encumbered with first-lien PACE loans...In making this determination, FHFA has carefully reviewed the Reserve Fund created by the State of California and, while I appreciate that it is intended to mitigate these increased losses, it fails to offer full loss protection to the Enterprises. The Reserve Fund is not an adequate substitute for Enterprise mortgages maintaining a first lien position and FHFA also has concerns about the Reserve Fund's ongoing sustainability. "

In August 2015, the Federal Housing Administration (FHA) announced the development of Single Family FHA PACE guidance. "The Single Family FHA guidance will address the impact of PACE assessment on purchases, refinances and loan modification options available to borrowers experiencing distress and will require the subordination of PACE financing to the first lien FHA mortgage. The guidance will address the eligible methods of subordination of existing PACE liens." The FHFA has not issued anything further following the announcement from FHA regarding the development of guidelines.

As part of the 2015-16 Budget, the Legislature tasked CAEATFA, in consultation with the California Public Utilities Commission, to create a working group with stakeholders to develop criteria for the comparative assessment of energy efficiency financing programs in California, including PACE financing. CAEATFA has created a public process to ensure stakeholder participation and draft criteria for the comparative assessment of energy efficiency financing programs for public comment.

Chaptered PACE Legislation

AB 811 (Levine and Beall), Chapter 159, Statutes of 2008, authorized all local governments to create PACE programs by designating areas within which the local agency and willing property owners may enter into contractual assessments to finance the installation of distributed generation renewable energy sources and energy efficiency improvements.

AB 474 (Blumenfield), Chapter 444, Statutes of 2009, expanded the use of voluntary contractual assessments to include financing water efficiency improvements.

AB 44 (Blakeslee), Chapter 564, Statutes of 2010, expanded the use of voluntary contractual assessments to include financing of power purchase agreements, and prohibited contractual assessments if the total amount of the assessments and taxes on the property exceeds 5% of the property's market value.

AB 184 (Swanson), Chapter 28, Statutes of 2011, expanded the use of voluntary contractual assessments to include financing seismic strengthening improvements.

AB 1883 (Skinner), Chapter 599, Statutes of 2014, allowed a public agency to transfer voluntary contractual assessments, if bonds have not been issued, and makes several other changes to the statutes governing voluntary contractual assessments.

SB 77 (Pavley), Chapter 15, Statutes of 2010, authorized CAEATFA to develop and administer a state PACE bond reserve program to pay bondholders in the event a PACE program had insufficient funds, which would reduce risk to bondholders and facilitate smaller interest rates.

SB 1340 (Kehoe), Chapter 649, Statutes of 2010, expanded the use of voluntary contractual assessments to finance electric vehicle charging infrastructure and correspondingly expanded the PACE bond reserve program.

SB 555 (Hancock), Chapter 493, Statutes of 2011, added the acquisition, installation, and improvement of energy efficiency, water conservation, and renewable energy improvements that are affixed to the types of facilities that a CFD may finance, or refinance, regardless of whether the buildings or property are privately or publicly owned.

SB 96 (Committee on Budget and Fiscal Review), Chapter 356, Statutes of 2013, created a PACE loss reserve program with a \$10 million reserve fund to keep mortgage interests whole during a foreclosure or a forced sale, to be administered by CAEATFA.

Additional Background Materials

FHFA Statement on Certain Energy Retrofit Loan Programs, FHFA, July 6, 2010.

Letter to President Barack Obama, Office of Governor Edmund G. Brown Jr, November 16, 2012.

Letter to FHFA Acting Director Edward DeMarco, PACE Program in California: Resolution of Fannie Mae and Freddie Mac Issues, Office of Governor Edmund G. Brown Jr, September 23, 2013.

FHFA Statement on Certain Super-Priority Liens, FHFA, December 22, 2014.

Letter to FHFA Director Mel Watt, PACE Program in California; Resolution of Enterprise Issues, Office of Governor Edmund G. Brown Jr, April 28, 2014.

Letter to Governor Edmund G. Brown Jr., California PACE Program, FHFA Office of the Director Melvin L. Watt, May 1, 2014.

Letter to FHFA Director Melvin L. Watt, PACE in California, Office of Governor Edmund G. Brown Jr, February 24, 2015.

Guidance for Use of FHA Financing on Homes with Existing PACE Liens and Flexible Underwriting through Energy Department's Home Energy Score, FHA Principal Deputy Assistant Secretary Ed Golding, August 24, 2015.

FEDERAL HOUSING FINANCE AGENCY



STATEMENT

For Immediate Release
July 6, 2010

Contact: Corinne Russell (202) 414-6921
Stefanie Mullin (202) 414-6376

FHFA Statement on Certain Energy Retrofit Loan Programs

After careful review and over a year of working with federal and state government agencies, the Federal Housing Finance Agency (FHFA) has determined that certain energy retrofit lending programs present significant safety and soundness concerns that must be addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks. Specifically, programs denominated as Property Assessed Clean Energy (PACE) seek to foster lending for retrofits of residential or commercial properties through a county or city's tax assessment regime. Under most of these programs, such loans acquire a priority lien over existing mortgages, though certain states have chosen not to adopt such priority positions for their loans.

First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.

FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.

While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities. Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption.

Efforts are just underway to develop underwriting and consumer protection standards as well as energy retrofit standards that are critical for homeowners and lenders to understand the risks and rewards of any energy retrofit lending program. However, first liens that disrupt a fragile housing finance market and long-standing lending priorities, the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns.

On May 5, 2010, Fannie Mae and Freddie Mac alerted their seller-servicers to gain an understanding of whether there are existing or prospective PACE or PACE-like programs in jurisdictions where they do business, to be aware that programs with first liens run contrary to the Fannie Mae-Freddie Mac Uniform Security Instrument and that the Enterprises would provide additional guidance should the programs move beyond the experimental stage. Those lender letters remain in effect.

Today, FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake the following prudential actions:

1. For any homeowner who obtained a PACE or PACE-like loan with a priority first lien prior to this date, FHFA is directing Fannie Mae and Freddie Mac to waive their Uniform Security Instrument prohibitions against such senior liens.
2. In addressing PACE programs with first liens, Fannie Mae and Freddie Mac should undertake actions that protect their safe and sound operations. These include, but are not limited to:
 - Adjusting loan-to-value ratios to reflect the maximum permissible PACE loan amount available to borrowers in PACE jurisdictions;
 - Ensuring that loan covenants require approval/consent for any PACE loan;
 - Tightening borrower debt-to-income ratios to account for additional obligations associated with possible future PACE loans;
 - Ensuring that mortgages on properties in a jurisdiction offering PACE-like programs satisfy all applicable federal and state lending regulations and guidance.

Fannie Mae and Freddie Mac should issue additional guidance as needed.

3. The Federal Home Loan Banks are directed to review their collateral policies in order to assure that pledged collateral is not adversely affected by energy retrofit programs that include first liens.

Nothing in this Statement affects the normal underwriting programs of the regulated entities or their dealings with PACE programs that do not have a senior lien priority. Further, nothing in these directions to the regulated entities affects in any way underwriting related to traditional tax programs, but is focused solely on senior lien PACE lending initiatives.

FHFA recognizes that PACE and PACE-like programs pose additional lending challenges, but also represent serious efforts to reduce energy consumption. FHFA remains committed to working with federal, state, and local government agencies to develop and implement energy retrofit lending programs with appropriate underwriting guidelines and consumer protection standards. FHFA will also continue to encourage the establishment of energy efficiency standards to support such programs.

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The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than \$5.9 trillion in funding for the U.S. mortgage markets and financial institutions.



OFFICE OF THE GOVERNOR

November 16, 2012

The Honorable Barack Obama
The White House
Washington, DC 20500

Dear President Obama:

I am writing to ask you again to direct the Federal Housing Financial Authority (FHFA) to work with California to revive the Property Assessed Clean Energy (PACE) program. This program provides home owners with funding for energy-efficiency retrofits, but the FHFA has blocked it by prohibiting Fannie Mae and Freddie Mac from repurchasing mortgages subject to PACE liens.

The FHFA maintains that its prohibition is needed to reduce Fannie's and Freddie's mortgage risk. But California is now prepared to eliminate any such risk by committing tens of millions of dollars to insure against PACE-related mortgage losses. With this commitment, there remains no plausible reason for the FHFA to continue obstructing the program.

Please direct the FHFA to work with my office on this insurance commitment so we can finally get the PACE program moving to stimulate the economy and protect the environment.

Sincerely,

Edmund G. Brown Jr.

Mr. President:

We can make this
work! Please help.



OFFICE OF THE GOVERNOR

September 23, 2013

Edward DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552-0003

Re: PACE Program in California; Resolution of Fannie Mae and Freddie Mac Issues

Dear Mr. DeMarco:

Last year, I asked President Obama to direct the Federal Housing Finance Agency to work with California to revive Property Assessed Clean Energy (PACE) programs, which provide home owners with funding for energy-efficiency retrofits. The Federal Housing Finance Agency prohibited Fannie Mae and Freddie Mac from purchasing mortgages subject to PACE liens in certain types of PACE programs.

California has devised a mechanism that will address the concerns raised by FHFA and protect the interest of Fannie Mae and Freddie Mac, which I describe below.

The California Alternative Energy and Advanced Transportation Financing Authority (Authority), an existing state agency chaired by the California State Treasurer (Division 16 [commencing with Section 26000] of the Public Resources Code), will create a reserve fund for PACE programs. Any PACE program that wishes to use the reserve fund will enter an agreement that requires the PACE program to make Fannie Mae and Freddie Mac whole, as follows:

1. In any foreclosure, for any losses to Fannie Mae and Freddie Mac resulting from the payment of any PACE assessment paid while in possession of the property, and
2. In any forced sale for unpaid taxes or special assessments, for any losses to Fannie Mae and Freddie Mac that result from PACE assessments being paid before the outstanding mortgage.

Edward DeMarco
September 23, 2013
Page 2

PACE programs that enroll in the Authority reserve fund will meet basic structural criteria, comply with underwriting criteria set by the Authority, and pay an annual premium based on the size of their portfolio. In the event of foreclosure, Fannie Mae and Freddie Mac will be able to claim from the PACE program any amounts paid to keep the PACE assessment current until the property is sold to a new buyer. If the property is sold for back taxes or special assessments, and the sale results in insufficient funds to satisfy the outstanding mortgage because of PACE lien priority payments, Fannie Mae and Freddie Mac will be able to recover that amount from the PACE program. In both instances, upon a showing that Fannie Mae and Freddie Mac have been paid by the PACE program, the Authority will reimburse the PACE program.

This process addresses the issues raised by the Federal Housing Finance Agency and ensures that Fannie Mae and Freddie Mac will not be adversely impacted by the PACE first lien. The next step in moving this approach to fruition will be for the Authority to issue draft regulations for public comment, setting forth the requirements for PACE programs to participate in the reserve account. We will provide you with notice of that process and invite your participation.

I look forward to moving ahead on a much larger scale with PACE in California.

Sincerely,



Edmund G. Brown Jr.

cc: Valerie Jarrett, Senior Advisor to the President, The White House
Alfred Pollard, General Counsel, Federal Housing Finance Agency
Bill Lockyer, Treasurer, State of California
Members of the California Congressional Delegation



Statement

Statement of the Federal Housing Finance Agency on Certain Super-Priority Liens

FOR IMMEDIATE RELEASE

12/22/2014

Today, the Federal Housing Finance Agency (FHFA) is alerting homeowners, financial institutions, and state authorities of the agency's concerns with state-level actions that threaten the first-lien status of single-family loans owned or guaranteed by Fannie Mae and Freddie Mac. In particular, FHFA is concerned about state actions to create super-priority liens in two instances: 1) through certain energy retrofit financing programs structured as tax assessments and 2) through granting priority rights in foreclosure proceedings for homeowner associations. In issuing this statement, FHFA is acting in furtherance of its statutory obligations as regulator and conservator of Fannie Mae and Freddie Mac.

The existence of these super-priority liens increases the risk of losses to taxpayers. Fannie Mae and Freddie Mac, while operating in conservatorship, currently support the housing finance market by purchasing, guaranteeing, and securitizing single-family mortgages. One of the bedrock principles in this process is that the mortgages supported by Fannie Mae and Freddie Mac must remain in first-lien position, meaning that they have first priority in receiving the proceeds from selling a house in foreclosure. As a result, any lien from a loan added after origination should not be able to jump in line ahead of a Fannie Mae or Freddie Mac mortgage to collect the proceeds of the sale of a foreclosed property. However, as is detailed below, FHFA is concerned by some liens being advanced to "super-priority" status over Fannie Mae and Freddie Mac first-lien mortgages.

Energy Retrofit Financing Programs Structured as Tax Assessments

While FHFA fully supports energy retrofit financing programs to allow homeowners to improve energy efficiency, these programs must be structured to ensure protection of the core financing for the home and, therefore, cannot undermine the first-lien status of Fannie Mae and Freddie Mac mortgages. Some entities and localities are advancing the argument that single-family energy retrofit financing programs that are structured to make loans through the homeowner's property tax assessment and require that borrowers repay their loans as part of their property tax bill should have priority over all other loans, including pre-existing Fannie Mae and Freddie Mac mortgages.¹ One such program is known as the Property Assessed Clean Energy (PACE) program, which often

provides loans as first-liens and is offered in California and in some other states. Localities offering these PACE loans threaten to move existing Fannie Mae and Freddie Mac mortgages to a second lien position and increase the risk of loss to the Enterprises and, by extension, to taxpayers.

In issuing this statement, FHFA wants to make clear to homeowners, lenders, other financial institutions, state officials, and the public that Fannie Mae and Freddie Mac's policies prohibit the purchase of a mortgage where the property has a first-lien PACE loan attached to it. This restriction has two potential implications for borrowers.

First, a homeowner with a first-lien PACE loan cannot refinance their existing mortgage with a Fannie Mae or Freddie Mac mortgage. Second, anyone wanting to buy a home that already has a first-lien PACE loan cannot use a Fannie Mae or Freddie Mac loan for the purchase. These restrictions may reduce the marketability of the house or require the homeowner to pay off the PACE loan before selling the house.

FHFA believes it is important for states and municipalities to understand these restrictions before continuing to offer the programs. Additionally, FHFA believes that borrowers should fully understand these restrictions prior to taking out a first-lien PACE loan.

In addition to aggressive enforcement of these existing policies, FHFA is continuing to explore other possible remedies and legal actions to protect the Enterprises' lien position in response to first-lien PACE programs.

Homeowner Association Priority Status

FHFA is aware that, in certain jurisdictions, liens for unpaid homeowner association ("HOA") dues may be deemed to be senior to preexisting mortgage liens on a homeowner's property. As a result, on December 5, 2014, FHFA and Fannie Mae filed an action in federal court in Nevada, seeking a determination that a HOA's foreclosure sale is invalid and contrary to federal law to the extent that it purports to extinguish Fannie Mae's property rights. *Federal National Mortgage Association v. SFR Investments Pool 1, LLC*, No. 2:14-cv-02046 (D. Nev. December 5, 2014). FHFA has also intervened in *Saticoy Bay, LLC Series 1702 Empire Mine v. Federal National Mortgage Assoc.*, No. 2:14-cv-01975 (D. Nev.), seeking a declaration that a prior HOA foreclosure sale is invalid to the extent that it purports to extinguish Fannie Mae's property interests.

These FHFA actions are based on federal law which precludes involuntary extinguishment of liens held by Fannie Mae or Freddie Mac while they are operating in conservatorships and bars holders of other liens, including HOAs, from taking any action that would extinguish a Fannie Mae or Freddie Mac lien, security interest or other property interest. Specifically, Title 12 USC Section 4617(j)(3) states that "[no] property of the Agency shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of the Agency, nor shall any involuntary lien attach to the property of the Agency." FHFA is authorized, as conservator, to bring this suit because Enterprise lien interests in collateral constitute property protected by this provision.

FHFA has an obligation to protect Fannie Mae's and Freddie Mac's rights, and will aggressively do so by bringing actions to void foreclosures that purport to extinguish Enterprise property interests in a manner that contravenes federal law.

1 PACE financing programs can be structured as secondary liens that stand behind the original mortgage and do not threaten the priority status of Enterprise loans.

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The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than \$5.6 trillion in funding for the U.S. mortgage markets and financial institutions.

Contacts:

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OFFICE OF THE GOVERNOR

April 28, 2014

Mel Watt
Director, Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552-0003

RE: PACE Program in California; Resolution of Enterprise Issues

Dear Director Watt,

The Federal Housing Finance Agency can help California unleash the full potential of Property Assessed Clean Energy (PACE) programs, which provide home owners with funding for energy-efficiency retrofits, renewable energy, and water efficiency. I have spoken directly to the President, Vice-President, and your predecessor, Director DeMarco about the importance of PACE financing to California and the country's response to climate change.

As you know, the FHFA prohibited Fannie Mae and Freddie Mac from purchasing mortgages subject to PACE liens in certain types of PACE programs. That prohibition hobbled a multi-billion dollar market. California has now adopted a mechanism -- a loss reserve fund -- that specifically protects the interests of Fannie Mae and Freddie Mac and insures that the federal government will not be harmed by the PACE first lien priority.

Let's discuss how to get this important program moving.

Sincerely,


Edmund G. Brown Jr.

cc: The Vice President
John Podesta, Counselor to The President

*Please - let's get
this program going!*



FEDERAL HOUSING FINANCE AGENCY
Office of the Director

May 1, 2014

The Honorable Edmund G. Brown Jr.
Governor, State of California
State Capitol
Sacramento, CA 95814

RE: California Property Assessed Clean Energy Program

Dear Governor Brown:

Thank you for your letter of April 28, 2014 about California's Property Assessed Clean Energy (PACE) program. The Federal Housing Finance Agency's (FHFA) General Counsel has been in touch with your staff, and I appreciate the time and materials they have provided concerning California's PACE program and intentions in creating the Reserve Fund.

I am writing to inform you that FHFA is not prepared to change its position on California's first-lien PACE program and will continue to prohibit the Enterprises from purchasing or refinancing mortgages that are encumbered with first-lien PACE loans. California's PACE program would allow local governments to finance energy-related home improvement projects by placing an assessment on a homeowner's property in a first lien position, resulting in the subordination of an existing Enterprise-backed mortgage to a second lien position. The effect of this is to increase the risks and possibility of losses to the Enterprises. Additionally, because these loans run with the land, the ongoing monthly assessments for PACE loans are passed on to any subsequent property owners – including after a foreclosure or other distressed sale – unless fully paid off beforehand.

In making this determination, FHFA has carefully reviewed the Reserve Fund created by the State of California and, while I appreciate that it is intended to mitigate these increased losses, it fails to offer full loss protection to the Enterprises. The Reserve Fund is not an adequate substitute for Enterprise mortgages maintaining a first lien position and FHFA also has concerns about the Reserve Fund's ongoing sustainability.

Should you wish to discuss this matter further, I would be happy to discuss alternatives to first-lien PACE programs with you.

Sincerely,

Melvin L. Watt

xc: The Honorable Barbara Boxer
The Honorable Zoe Lofgren



OFFICE OF THE GOVERNOR

February 24, 2015

Mr. Mel Watt
Director, Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552-0003

Re: PACE in California

Dear Mr. Watt:

mel

I renew my request that the Federal Housing Finance Agency work with California to unleash the full potential of Property Assessed Clean Energy (PACE) programs, which provide home owners with funding for energy-efficiency retrofits, renewable energy, and water efficiency. Given California's aggressive climate pollution response and our devastating drought, PACE is an essential policy tool.

I am concerned, in light of your recent testimony before Congress, that you do not have the full picture of the California PACE program and the protections that we have devised for Fannie Mae and Freddie Mac, as well as further measures that we can take if the FHFA will work with California to find an acceptable solution.

California state law places PACE obligations in the first lien position, but California's loss reserve fund ensures that Fannie and Freddie will not be harmed by the first lien. If we can engage in meaningful discussion with FHFA, we undoubtedly can find mechanisms that provide further protection for federal interests. In addition, we can discuss statewide standards, data collection and tracking, and consumer protections in conjunction with the first lien priority issues. Despite years of effort by California, FHFA simply has not engaged in a meaningful discussion about solutions. I request your direct involvement to make this happen.

The worst outcome would be a unilateral action by FHFA against a PACE lender or program, which would put California and the FHFA on an adversarial path. We need to find a workable solution instead.

I look forward to a productive discussion.

Sincerely,

Jerry Brown
Edmund G. Brown Jr.

cc: The Vice President
Denis McDonough

Can't we get this done?



from the
Desk of Ed Golding
Principal Deputy Assistant Secretary for
Housing and Head of the FHA



August 24, 2015

Guidance for Use of FHA Financing on Homes with Existing PACE Liens and Flexible Underwriting through Energy Department's Home Energy Score

HUD.gov/FHA

HUD Press
Releases

Today, FHA announced anticipated guidelines for two new initiatives that will support borrowers seeking to make energy efficient improvements to their homes, including guidance that will allow borrowers to use Single Family FHA financing for properties with existing Property Assessed Clean Energy (PACE) loans that meet certain conditions. FHA also announced its new partnership with the Department of Energy (DOE) helping borrowers using Single Family FHA's Energy Efficient Home (EEH) program to take advantage of energy cost savings when measured by DOE's Home Energy Score.

PACE Guidance

PACE programs have the potential to increase the accessibility and affordability of energy saving measures, consequently lowering energy bills to residents and reducing the environmental footprints of participating localities.

Single Family FHA supports responsibly expanding access to clean energy financing options for creditworthy borrowers. Single Family FHA PACE guidance has the potential to allow homeowners to benefit from energy cost savings while preserving the marketability of properties with PACE loans.

In 2009 and 2010, many states adopted legislation allowing local governments to fund home energy improvements that are repaid by assessments levied under their tax authority. While there are many versions, PACE programs generally allow homeowners to finance energy efficiency improvements for up to 20 years through tax assessments attached to the property. PACE allows homeowners to benefit from the improvements immediately and spread the cost over time.

When the property is sold, the PACE loan may transfer to the next owner who is responsible for repaying the loan. The ability to transfer the loan to the new owner allows for both the payment and the value of the retrofit to be transferred from one owner to the next.

Since in the event of default, the PACE loan as a tax assessment may have super lien status and/or take precedence over the first lien mortgage, some lenders have raised concerns. FHA is developing Single Family PACE guidance to overcome impediments in the purchase and sale of properties to which PACE loans are attached due to these concerns.

The Single Family FHA guidance will address the impact of PACE assessments on purchases, refinances and loan modification options available to borrowers experiencing distress and will require the subordination of PACE financing to the first lien FHA mortgage. The guidance will address the eligible methods of subordination of existing PACE liens.

Taking into account the variety of types of residential PACE programs, FHA is developing PACE guidance, which is also being informed by ongoing conversations with the Federal Housing Finance Agency (FHFA), that at a minimum will include the following:

- **Lien Position:** Only PACE liens that preserve payment priority for first lien mortgages through subordination;
- **PACE payment, structure, and term:** PACE financing must be a fixed-rate, fully amortizing loan;

- **Eligible Properties:** PACE assessments must be attached to single family properties, as defined by FHA, which are 1- to 4-unit dwellings, including detached, semi-detached and townhome properties;
- **Equity Requirement:** PACE liens that preserve payment priority for first lien mortgages will be eligible for financing that does not exceed FHA's maximum combined loan-to-value (CLTV) ratio;
- **Record Keeping:** PACE liens must be formally recorded and be identifiable to a mortgage lender through a title search;
- **Additional Consumer Protections:** PACE programs must comply with applicable federal and state consumer laws and should include disclosures to and training for homeowners participating in the program.

PACE programs operate at the local level and vary widely. DOE PACE "Program Design Best Practice Guidelines" recommend key program requirements for acceptable PACE programs including the following:

- PACE programs should require notification of mortgage holders of record when a PACE assessment has been placed on the property;
- PACE programs should finance PACE projects that are cost-effective and reduce the net energy requirements as measured by approved DOE methods.

In finalizing guidance, FHA will work with the Consumer Financial Protection Bureau, DOE, Treasury and other industry stakeholders to advocate for strong consumer protections.

New Standards for FHA Single Family Energy Efficient Home – Incorporating DOE's Home Energy Score

FHA has partnered with DOE on an initiative that allows consumers to qualify for a higher loan amount due to cost savings associated with energy efficient improvements. Under the new FHA and DOE partnership, FHA will provide flexible underwriting to recognize the reduced costs of utilities when those costs are established with the Department of Energy's (DOE) Home Energy Score in areas where the Home Energy Score is available.

DOE's new Home Energy Score is a low cost, reliable method for estimating the energy use of a home. The score is the equivalent of an easily-understood "miles per gallon" label for homes. The score measures the energy efficiency of homes on a scale of 1–10. Homebuyers or homeowners who want to obtain an FHA-insured purchase or refinance mortgage for a single family home that receives a Home Energy Score of 6 or higher will be eligible to increase their income qualifying ratio by 2 percentage points above the standard Single Family FHA limit. This means that FHA borrowers will be able to borrow slightly more when they buy or refinance a more energy-efficient home through FHA's EEH program.

Through this partnership, FHA is supporting efforts to provide potential homeowners with an easy way to measure the energy efficiency of their homes and to identify the combination of investments that will help make their homes more energy efficient.

A Single Family FHA Mortgagee Letter with specific program requirements/details and an update to the Single Family Housing Handbook 4000.1 to address the guidance for both of these initiatives will be forthcoming in the next several months.